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MDU - Q2 2020 MDU Resources Group, Inc. Earnings Call

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OVERVIEW:

Co. reported 2Q20 earnings of \$99.7m, or \$0.50 per share. Expects 2020 EPS to be \$165-185.



CORPORATE PARTICIPANTS

David C. Barney President & CEO of Knife River Corporation

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Jeffrey S. Thiede President & CEO of MDU Construction Services Group, Inc.

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Christopher Ellinghaus Siebert Williams Shank & Co., L.L.C., Research Division - Principal & Senior Equity Utility Analyst

Ryan Levine Citigroup Inc., Research Division - VP

PRESENTATION

Operator

Hello. My name is Lori, and I will be your conference facilitator. At this time, I would like to welcome everyone to the MDU Resources Group 2020 Second Quarter Conference Call. (Operator Instructions) This call will be available for replay beginning at 5:00 p.m. Eastern Time today through 11:59 p.m. Eastern Time on August 19. The conference ID number for the replay is 8684589. The number to dial for the replay is 1 (855) 859-2056 or 404-537-3406.

I would now like to turn the conference over to Jason Vollmer, Vice President, Chief Financial Officer and Treasurer of MDU Resources Group. Thank you. Mr. Vollmer, you may begin.

Jason L. Vollmer - MDU Resources Group, Inc. - VP, CFO & Treasurer

Thank you, Lori, and welcome, everyone, to our Second Quarter 2020 Earnings Release Conference Call. We sincerely hope that you and your families are well during this time.

Our conference call is being broadcast live to the public over the Internet, and slides will accompany our remarks. If you would like to view the slides, you can find them on the Events and Presentations page under the Investor tab of our website at www.mdu.com. Our earnings news release is also available on the website.

During the course of this presentation, we will make certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. Although the company believes that its expectations and beliefs are based on reasonable assumptions, actual results may differ materially. For a discussion of factors that may cause actual results to differ, refer to Item 1A Risk Factors in our most recent Form 10-K.

Today, I will start by briefly covering this quarter's financial results and then turn the presentation over to Dave Goodin, President and CEO of MDU Resources, for an update on our forecast for the remainder of 2020 and looking forward. After Dave's remarks, we will open the line for questions.

In addition to Dave and myself, members of our management team who will be available to answer questions today and are dialing in from multiple locations are: Dave Barney, President and CEO of Knife River Corporation; Jeff Thiede, President and CEO of MDU Construction Services Group; Nicole Kivisto, President and CEO of our Utility Group; Trevor Hastings, President and CEO of WBI Energy; and Stephanie Barth, Vice President, Chief Accounting Officer and Controller of MDU Resources.



Yesterday, we announced second quarter earnings of \$99.7 million or \$0.50 per share compared to second quarter 2019 earnings of \$61.8 million or \$0.31 per share. This is an increase of 61% year-over-year. Our combined utility business reported record second quarter earnings of \$11.2 million, a significant increase from earnings of \$1.2 million in the second quarter of 2019. The electric utility segment reported earnings of \$12.2 million for the quarter compared to \$7.5 million for the same period in 2019. This earnings increase was largely a result of a \$4.6 million decrease in operation and maintenance expense, which includes the absence of a prior year planned outage at the Coyote Station as well as lower payroll-related costs.

The company also benefited from higher investment returns on certain benefit plans in the quarter. The absence of a prior year write-down on a nonutility investment also had a positive impact on earnings. Higher residential electric sales drove an increase in retail sales margins, which was partially offset by lower industrial and commercial sales volumes. The increase in earnings was partially offset by higher depreciation, depletion and amortization expense.

Our natural gas utilities segment reported a seasonal loss of \$1 million improved from a seasonal loss of \$6.3 million for the same period in 2019. Adjusted gross margin increased during the quarter as a result of weather normalization and conservation adjustments, approved rate recovery and a 4.3% increase in retail sales volumes. This increase in natural gas retail sales was driven by higher residential sales, offset somewhat by lower industrial and commercial volumes. Like the electric side, higher investment returns on certain benefit plans and the absence of the prior year write-down on a nonutility investment were also beneficial in the quarter. Higher depreciation, depletion and amortization expense from increased property, plant and equipment balances partially offset the decreased loss.

The pipeline business had earnings of \$9 million in the second quarter compared to \$7.1 million in the second quarter of 2019. This business saw increased revenues from its Demicks Lake, Line Section 22 initial phase and Demicks Lake Expansion growth projects, which were placed into service in late 2019 and early 2020 as well as seeing strong customer demand for storage services in the quarter due to seasonal price differentials. Higher investment returns on certain benefit plans also had a positive impact on this segment's earnings.

Turning now to our construction businesses. Construction services reported a record second quarter earnings of \$27.9 million compared to \$22.8 million in 2019. This business also reported record second quarter revenues of \$497.2 million, up from second quarter 2019 revenues of \$464.9 million. Demand for construction services remains high for both inside and outside specialty contracting. Inside specialty contracting was busy with hospitality, data center and commercial work and the outside contracting workloads increased from high demand in the utility industry. Increased workloads were partially offset by higher selling, general and administrative costs, primarily payroll-related as this business operated at record employment levels for the second quarter.

Our construction materials business also reported record results for the second quarter with \$53 million in earnings, up 82% from the prior year's \$29.2 million. Revenues were also a record for the second quarter at \$621.1 million compared to \$596 million for the same period in 2019. The increase in earnings was driven by higher contracting and material's margins and revenues. Favorable weather across this business's footprint allowed for higher product sales and the ability to work through more backlog than typical for the second quarter, which drove the increase in margins. Earnings in this segment also benefited from higher investment returns on certain benefit plans.

While these higher investment returns on benefit plans positively affected earnings for all segments, the combined impact was only \$6.2 million or 16% of the \$37.9 million increase in earnings from quarter-to-quarter. All businesses lines successfully contained operating costs and we continued providing essential services to our customers during this unprecedented time, and we were also able to deliver exceptional year-over-year earnings growth.

That summarizes the financial highlights from the quarter. And now I'd like to turn the call over to Dave for his formal remarks. Dave?

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Well, thank you, Jason, and thank you to everyone listening for spending your time with us today and for your continued interest in MDU Resources. We hope that everyone there is safe and healthy.



I want to start out by saying thank you to our more than 15,000 employees for making this a very successful quarter. Our financial results, which we released yesterday, show the continued strength of our 2 platform business model and underscores our ability to continue providing essential services across our business lines during this challenging economic time.

Given the strong performance that we saw in the quarter with record revenues at both construction companies, new record combined construction backlog and the excellent results from our regulated energy delivery companies, we are raising our earnings per share guidance for 2020 to now a range of \$1.65 to \$1.85 per share. Looking at our forecast for the remainder of 2020 and our performance in the second quarter, we're also raising revenue guidance for both construction services and construction materials as well as reinstating margin guidance. We now expect construction services to end the year with revenues in a range from \$1.9 billion to \$2.1 billion with margins comparable to 2019 levels, and construction materials revenues now in a range of \$2.2 billion to \$2.4 billion with margins actually slightly higher than what we saw in 2019.

Turning to the regulated energy delivery platform. Our utility business filed several regulatory cases to record costs incurred associated with providing safe and reliable electric and natural gas service to our now 1.13 million customers. We continue to see strong customer growth across our service territory. In fact, on a year-over-year basis, customer growth has been slightly higher than 2%. During this quarter, the utility received approval from the Montana Public Service Commission to defer accounting costs related to the closure of our Lewis & Clark and Heskett electric generating facilities. We announced the closure of these 2 facilities at the beginning of 2019, along with our intent to build an 88-megawatt natural gas-fired electric generating facility. And just this morning, the North Dakota Public Service Commission approved an all-party settlement on our applications relating to the deferred accounting order relating to the costs associated with retiring the current facilities along with the advanced determination of prudence filing related to the 88-megawatt Heskett 4 station.

In response to the coronavirus pandemic, the utility filed with public service commissions in all eight states a request to defer accounting for costs related to the crisis and has received approval from Idaho, Minnesota and Wyoming to date. Natural gas general cases were also filed in the states of Montana and Washington during the quarter, requesting increases of 13.4% and 5.3%, respectively.

At our pipeline business, we also had a great second quarter, showing the success of our organic growth projects. This business also benefited from increased volumes of natural gas being transported to our storage facilities as customers took advantage of seasonal commodity price differentials. The company continues to work on the planning and the regulatory filings required for the North Bakken expansion project in Western North Dakota, and we expect construction to begin on this project early in 2021. In July, this business filed with the Federal Energy Regulatory Commission an amendment to its application for this project. Revised forecast for Bakken natural gas production showed slower growth, so we have decided to decrease the initial design capacity of this project to now 250 million cubic feet per day, simply by reducing compression, which in turn, reduces the anticipated capital expenditures for the project. The size of the pipe used for this project will remain the same, allowing us to scale up capacity by increasing compression as Bakken production rebounds. We expect this project to be in service in late 2021.

Now I'd like to move on to construction. Our Construction Services Group had simply an outstanding second quarter as demand for both inside and outside specialty contracting remains strong. CSG reported record revenues, record earnings and record backlog, all while working under modified conditions to protect the health and safety of our employees and customers during the pandemic. While this business did see slowdowns on a handful of projects as it relates to COVID-19, the strong demand that we have for its services has kept our crews working, and we've only added to our backlog. CSG ended the quarter with a record \$1.31 billion in backlog, showing the strength of the bidding opportunities across this business' footprint. As a reminder, we are increasing revenue guidance at this business to now a range of \$1.9 billion to \$2.1 billion, with margins comparable to 2019 levels.

And finally, our largest contributor to earnings for the quarter is our construction materials business. This business, like construction services, reported record revenues and earnings in the second quarter. Favorable weather across this business' markets allowed the company to begin work on projects earlier, thus working through more backlog than typically completed in the second quarter. The good weather paired with recent acquisitions drove more product sales, and in turn, resulted in higher margins. Construction materials backlog at June 30 stood at \$875 million and is the second highest on record, falling short only of last year's record second quarter backlog of \$1.04 billion.



We have seen a decline in a number of new projects awarded in the quarter, which we believe stems from economic uncertainty as a result of COVID-19. While bidding out new projects has been challenging under pandemic-related working conditions, we are excited about the opportunities in front of this business and the strong bidding opportunities we see going later into this construction season.

So to bring all of this together, we had a very strong performance across all business lines here in the second quarter. While we continue to navigate through the changing and challenging times as it relates to COVID-19 and its response, we have been able to continue to provide the essential services to support the infrastructure that our nation needs. Our workforce has also grown over the last quarter. And as of June 30, we are actually at record employment levels for the corporation with 15,247 employees, nearly 1,000 employees higher than at this same time last year. It is this type of growth in our companies that allows us to continue building a strong America. As always, MDU Resources is committed to operating with integrity, along with a focus on safety while creating superior shareholder value as we continue providing essential services to our customers.

I certainly appreciate your interest in and commitment to MDU resources and ask now that we open the line to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Chris Ellinghaus of Sebert Williams.

Christopher Ellinghaus - Sebert Williams Shank & Co., L.L.C., Research Division - Principal & Senior Equity Utility Analyst

How should we think about the second quarter for construction materials? If you had a jump-start as the weather, should we be thinking about you've shifted some from the third quarter? Or does that give you extra capacity to go out and work in the third quarter? And how should we be thinking about timing of construction?

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Sure, Chris. I'll ask Dave Barney to touch on that. Dave?

David C. Barney - President & CEO of Knife River Corporation

Chris, yes, we did get out to a good second quarter, but you see, we have that record -- second best record backlog going into that third quarter. So we definitely have the capacity to do more work in the third quarter. Last year, in September, we had quite a bit of rain that affected some of our regions. So we're excited about the third quarter. We're excited about this year. It looks good for us for the rest of the year.

Christopher Ellinghaus - Sebert Williams Shank & Co., L.L.C., Research Division - Principal & Senior Equity Utility Analyst

It looks like the weather has been pretty cooperative in July. Is that the way you see it?

David C. Barney - President & CEO of Knife River Corporation

Absolutely. We've had no effect from the weather in July.



Christopher Ellinghaus - Seibert Williams Shank & Co., LLC, Research Division - Principal & Senior Equity Utility Analyst

Okay. It looks like there's been some slowdown in your ability to add back to backlog in the quarter. Is that a state budgetary constraint because of COVID-19? Is that commercial activity? What -- can you give us a little color on that?

David C. Barney - President & CEO of Knife River Corporation

Really, Chris, it's -- we burned through more backlog in the second quarter because of the favorable weather. We've pretty much seen -- we don't do a lot of bidding in the second and third quarter. Most -- typically, most of our bidding starts in January and February for next year. We'll burn through most of our backlog that we have right now, probably have about 20% that carries over to next year. But we've seen a few jobs cancel or delay, but not that many right now.

Christopher Ellinghaus - Seibert Williams Shank & Co., LLC, Research Division - Principal & Senior Equity Utility Analyst

Okay, great. Can you give me a little color on what you're seeing in the Vegas market? Is there some slowdown in expected projects there from -- obviously, they've got some revenue problems?

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Yes. Thank you, Chris. We'll turn it over to Jeff Thiede to touch on the CSG businesses in that Vegas market. Jeff?

Jeffrey S. Thiede - President & CEO of MDU Construction Services Group, Inc.

Thanks for the question, Chris. We're very busy in Las Vegas. Our hours are up and we have quite a bit of backlog, about 30% of our backlog is in the Vegas market where we're working on, of course, the hospitality work but also mission-critical work. And we just finished up the Allegiant football stadium on the fire protection side and then the headquarters and practice facility on the mechanical side. So an example of our diversified business. There has been a project that we were involved in and it was not in our backlog that did get postponed indefinitely. And there is another project that we have reduced our workforces temporarily. And we're looking for that job to restart.

Christopher Ellinghaus - Seibert Williams Shank & Co., LLC, Research Division - Principal & Senior Equity Utility Analyst

Okay. And one last thing. Some states are looking to accelerate some infrastructure spend to stimulate their local economies. Can you talk about what you've been hearing from your various states in terms of their desire to use the utilities as sort of economic stimulus?

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Yes, Chris. Nicole is here with us. She can touch on that. I know Minnesota is one of the states that you're touching -- you're talking about.

Nicole A. Kivisto - CEO & President of Cascade Natural Gas Corp, Intermountain Gas Co & Montana-Dakota Utilities Co.

So Chris, just to clarify from a utility perspective, I'm not sure if you're asking it from a broader perspective, but I will certainly answer on behalf of the utility. We have seen that coming out of our 8 states, in particular, Minnesota has highlighted that. And you've probably seen some of our peer companies do some announcements on that. Certainly, when we look at our Minnesota operations, we're obviously a smaller player in that state. But we are doing what we can to accelerate a few of the projects that we have in that area and commit to the capital that we had already budgeted in that state. We are currently in an active rate case in that state as well. So hopefully, that answers your question from a utility perspective.

Christopher Ellinghaus - Seibert Williams Shank & Co., LLC., Research Division - Principal & Senior Equity Utility Analyst

Well, I'm just curious whether -- Minnesota is not the only state that has done this before. I'm just curious whether it's spreading to some of your other jurisdictions or whether you want to recommend that or have recommended that to some of the other states?

Nicole A. Kivisto - CEO & President of Cascade Natural Gas Corp, Intermountain Gas Co & Montana-Dakota Utilities Co.

Yes. From a utility-specific perspective, we haven't seen a whole lot of other activity in some of our other states. So -- and are we pushing it might be your other question that you're asking. As we look at our capital program, we've got a fair amount in the pipeline already, Chris. And we, obviously, as we think about the economic environment that we're in, we're doing our best to manage as we think about what the impact to some of these capital programs might be for our customers. And so certainly, we're well aware of that and are doing what we can to continue to invest in the communities and manage our capital accordingly. So again, no, I would just, in summary, say, not a significant impact in any of our other states.

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Chris, I'll jump in and ask Jeff Thiede to comment. But certainly, we've got utility customers as it relates to our CSG lines of business. Anything to add there, Jeff, from our outside line business that we would see from our utility clients there?

Jeffrey S. Thiede - President & CEO of MDU Construction Services Group, Inc.

Yes, we're seeing continued strong demand for our services and the transmission distribution, power, gas, and also communications. Our employment levels are up with all of our businesses. We have strong forecast for these businesses as we continue to see demand for our services with our utility customers.

Operator

(Operator Instructions) Your next question comes from the line of Ryan Levine of Citi.

Ryan Levine - Citigroup Inc., Research Division - VP

You mentioned the legal challenges for some of the other Bakken pipelines. Could you comment on the current key milestones for getting the North Bakken expansion in service by late '21 target?

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Sure. Ryan. Trevor Hastings is with us today. I'll ask Trevor to touch on that one.

Trevor J. Hastings - President & CEO of WBI Holdings, Inc.

Sure. The -- I think the primary challenge that we had run into was the Montana district court ruling on the Keystone XL project, which had basically removed the nationwide Permit 12 for new gas and oil pipelines. In early July, I think it was July 6, the Supreme Court basically overturned that. So that the ruling just resulted in a stay on Keystone XL, but opened up the nationwide Permit 12 to the -- to new oil and gas pipelines.

So from that standpoint, it put back in play that as an option, which is the permit we typically use on our projects. Our time line is we have filed with FERC early this year, we filed the amendment, as referenced in Dave's notes in the earnings release, here last week. And we'll be making our

permit filing, I think it's in the next 1 to 2 months probably, Ryan. And then really, from that point, our FERC approval is the next main approval or certificate to proceed. And so that should be in early 2021 and then construction would begin sometime in the Spring time frame.

Ryan Levine - Citigroup Inc., Research Division - VP

Okay. So there's no legal challenges outside of the FERC process from your perspective?

Trevor J. Hastings - President & CEO of WBI Holdings, Inc.

Not at this point in time, no.

Ryan Levine - Citigroup Inc., Research Division - VP

Okay. Switching gears, what's your current volume growth outlook for aggregates in the second half of the year that's embedded in guidance? And what drove the material change in construction guidance from a few months ago?

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

You're talking in the construction materials space, correct, Ryan? You broke up just a little bit there.

Ryan Levine - Citigroup Inc., Research Division - VP

Yes. In construction materials, specifically in the aggregate volume outlook?

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Dave Barney, could you address that?

David C. Barney - President & CEO of Knife River Corporation

Yes. Ryan, aggregate volume outlook for the rest of the year? Is that what you're talking about?

Ryan Levine - Citigroup Inc., Research Division - VP

Correct.

David C. Barney - President & CEO of Knife River Corporation

Okay. Yes. We're looking at being about where we were last year. As far as the aggregate, it's not a big increase in additional volumes. It's staying pretty steady. We are getting price increases on our aggregate. So that's definitely helping the margins.

Ryan Levine - Citigroup Inc., Research Division - VP

And in terms of the inputs that drove the guidance revision in this division from the guidance last quarter, is it primarily a pricing outlook difference or a volume outlook difference or a weather? Or are there other factors at play?



David C. Barney - President & CEO of Knife River Corporation

Well, I think it had a lot to do with that we had a record second quarter. That definitely helped. And with our second strongest backlog going into the third quarter, I think that was -- that played a part, too, Chris -- Ryan.

Ryan Levine - Citigroup Inc., Research Division - VP

Okay. And then in terms of contribution on EBITDA from acquisitions that's embedded in this division, is there a way to break that out or provide any color if that was a factor in year-over-year comparison?

David C. Barney - President & CEO of Knife River Corporation

Yes. I don't have definite numbers on that, Ryan. But the new companies, the new acquisitions played a very small part. Most of the EBITDA came from existing companies.

Operator

(Operator Instructions) Again, this call will be available for replay beginning at 5:00 p.m. Eastern Time today through 11:59 p.m. Eastern Time on August 19. The conference ID number for the replay is 8684589.

At this time, there are no further questions. So I would now like to turn the conference back over to management for closing remarks.

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Well, I'd like to thank you for taking the time to join us on our second quarter earnings call here today. As a reminder, we were able to post record results at our businesses while all working under modified conditions as it relates to the COVID-19 pandemic. Given our strong results in the first half of the year, we have increased our earnings per share guidance range to now to \$1.65 to \$1.85 for 2020, along with having reinstated guidance margins at both of our construction businesses.

Thank you, again, for taking the time to join us on the second quarter earnings call, and we do appreciate your continued interest and the support of MDU Resources. And with that, I will turn this back to the operator.

Operator

Thank you. This concludes today's MDU Resources Group conference call. We thank you for your participation. You may now disconnect.



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